No. 14,953

United States Court of Appeals

For the Ninth Circuit

JOHN O. ENGLAND, Trustee of the Estate of Daniel E. Sanderson, Bankrupt,
Appellant,

vs.

DANIEL E. SANDERSON, Bankrupt,
Appellee.

APPELLANT'S CLOSING BRIEF.

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MISSTATEMENT OF FACTS BY APPELLEE

Appellee throughout his brief erroneously states that he, the bankrupt, had only one creditor whose claim arose before the September 15, 1953 amendment to Section 1260, California Civil Code, increasing the California homestead exemption from $7,500.00 to $12,500.00. The finding of the referee was that there was "at least" one such creditor (Tr. p. 16), and the district judge referred to "creditors" (Tr. p. 67). Appellee's verified Schedule A-3 accompanying his petition in bankruptcy, which is part of the record on appeal, discloses that he had forty-one creditors who became such in 1952 and 1953 and whose claims totaled $18,440.01; whereas thirty-one

creditors with $5,752.98 worth of claims arose subsequent thereto.[1] We have omitted reference to those claims which are set forth as being contingent or disputed.

SUMMARY OF APPELLANT'S POSITION

Appellant's position will be more fully stated hereafter in connection with his reply to specific points advanced by appellee.

The major premise conceded by all is that under Section 6 of the Bankruptcy Act the District Court sitting in bankruptcy is required to allow to the bankrupt the exemptions prescribed and in force at the time of the filing of the petition in bankruptcy in the state of the bankrupt's domicile—California in the instant case.

The next premise is the well-settled rule that the federal court is bound by the construction given such statutes by the highest court of the states construing the statute.

> 3 Remington on Bankruptcy, Section 1294;
> *Dixon v. Koplar* (CCA 8th), 102 Fed. 2d 295;
> *West v. American Tel. & Tel. Co.,* 311 U.S. 223, 85 L. Ed. 139, 61 S. Ct. 179.

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[1]While the prineiple might be the same were there only one creditor, in view of the $18,000.00 indebtedness which arose prior to 1953, this court is not called upon to determine the applicability of the doctrine of *Moore v. Bay,* infra, to a situation where the property is worth, for example, $12,500.00, and less than $5,000.00 worth of indebtedness arose in 1952 and 1953.

In almost every state, including California, the state courts have held that where an exemption is enlarged the amendment gives no right to the debtor as against creditors whose claims arose prior to the amendment.

> *In re Rauer's Collection Co., Inc.,* 87 C.A. 2d 248, 196 Pac. 2d 803.

(See also note in 93 A.L.R. 177 collecting many cases throughout the country on the subject.)

The Supreme Court of the United States, in *Edwards v. Kearzey,* 96 U.S. 595, 24 L. Ed. 793, held a provision in the Constitution of North Carolina which exempted from sale a homestead to be invalid as regards contracts made before the adoption of the Constitution. The court, at page 799, stated:

> "The remedy subsisting in a State when and where a contract is made and is to be performed is a part of its obligation, and any subsequent law of the State which so affects that remedy as substantially to impair and lessen the value of the contract is forbidden by the Constitution, and is, therefore, void."

This is but another way of saying that in *every* exemption statute there is an implied provision that any amendment thereof substantially increasing the amount of the exemption will not affect an existing creditor.

The trustee in setting aside exempt property sets aside the exemption allowed by state law as against the oldest creditor in point of time—in the instant

case, a $7,500.00 exemption. (*In re Fox* (D.C.S.D. Cal.), 16 Fed. Supp. 320)[2]

One of the reasons for this rule is that as against at least some of the creditors of the bankrupt, the exemption was only $7,500.00; hence that was the exemption allowed the bankrupt by the laws of California in force at the time of the filing of the petition. To set aside to the bankrupt under such circumstances a $12,500.00 homestead would be to give him, in bankruptcy, $5,000.00 more than the exemption laws of California provide. It is not difficult to assume a situation where a petition is filed shortly after the amendment of the state law and all the claims of creditors arose before the effective date of the amendment.

Involved in the instant case is the title of the trustee to assets of the bankrupt. The trustee, under Section 70a of the Bankruptcy Act, takes title to all property not exempt. If only $7,500.00 is exempt, the trustee takes title to the excess.

Kilgo v. United Distributors (CCA 7th), 223 Fed. 2d 167;

In re Miller, 95 Fed. 2d 441;

Bank of Nez Perce v. Pindel (CCA 9th), 193 Fed. 917, 28 ABR 69.

In *Kilgo v. United Distributors,* supra, the court stated:

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[2]Appellee, at page 18 of his brief, states that the District Court in the *Fox* case held the automobile exemption invalid as to a particular creditor. The court held it invalid as against the *Trustee.*

> "It is well settled that when it becomes apparent the homestead property does not exceed the exemption, it is the duty of the Trustee to disclaim it as property of the bankrupt; and one holding a waiver, as here, may enforce his claim in the state court without regard to bankruptcy. 161 A.L.R. 1015 and authorities cited. If an appraisal establishes a value in excess of the homestead, the trustee may sell the property and pay the bankrupt the amount provided under the Constitution, *adding the excess to the fund for distribution to the general creditors.*" (Emphasis added)

The California statute setting up the procedure for reaching the excess is found in Sections 1245 et seq. of the Civil Code. The statute gives an *execution creditor* the right to have the property appraised, and provides that if the property is found to be worth more than the statutory exemption, it should be sold and the value of the homestead exemption given to the bankrupt and the excess used to satisfy the creditor's claim. Similar statutes have been construed to give the trustee the right to sell the property, pay the bankrupt the amount of the exemption and distribute the balance as assets of the estate (*In re Miller,* supra).[3]

Under the provisions of Section 70c of the Bankruptcy Act the trustee is vested with the rights of

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[3]This court has held on at least two occasions that before the property is sold the bankrupt should, as a matter of equity, be given the opportunity of paying to the trustee the difference between the homestead exemption and the value of the property. (*Bank of Nez Perce v. Pindel,* supra, and *Russell v. Laugharn,* 20 Fed. 2d 95.)

a lien creditor as against this excess value over the homestead exemption as construed by the California courts, to wit, $7,500.00. (We have heretofore pointed out that this Court has held that Section 70c is applicable in determining the validity of a homestead. *Sampsell v. Straub,* 194 Fed. 2d 288) The trustee's presumed lien includes the claims of creditors whose claims arose before the effective date of the $12,500.00 amendment, as well as the claims of creditors that arose thereafter.

The Supreme Court in *Moore v. Bay,* 284 U.S. 4, 76 L. Ed. 133,[4] laid down the rule of equality of distribution; that is to say, that the claims of creditors who were entitled to take advantage of an act or omission (in that case, the failure to comply with Section 3440 of the California Civil Code) stand equally with those creditors who could not take advantage of the act or omission had bankruptcy not intervened; in other words, the recovery made by the trustee was for the benefit of all creditors including those who could not have complained in the state court.

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[4]In this case the bankrupt executed a mortgage that was admittedly bad as against creditors who were such at the time of the mortgage and who became such prior to recordation, the parties having failed to comply with Section 3440 of the California Civil Code. "The question raised is whether the mortgage is void also as against those who gave the bankrupt credit at a later date after the mortgage was on record." Justice Holmes stated as one of his reasons for reversing this court: "The rights of the trustee by subrogation are to be enforced for the benefit of the estate. The Circuit Courts of Appeal seem generally to agree, as the language of the Bankruptcy Act appears to us to imply very plainly, that what thus is recovered for the benefit of the estate is to be distributed in 'dividends of an equal percentum on all allowed claims, except such as have priority or are secured.'"

COMMENT UPON APPELLEE'S POINTS

Certain arguments of the appellee require further comment.

The question of whether homestead laws are to be liberally or strictly construed (Appellee's Brief, p. 4) is not involved in the instant case. The only question is whether in applying California law the court can give the 1953 amendment a retroactive effect as against the trustee in bankruptcy. In view of the fact that the state courts have held that a creditor has a vested right in an existing exemption statute, we repeat: Neither a liberal nor a strict construction of the statute will help in answering this question.

Appellee argues that exempt property does not pass to the trustee (Appellee's Brief, p. 6). This begs the question. All that is exempt in the instant case is the first $7,500.00 or $12,500.00 of the value of the home, as the case may be. The bankruptcy court must determine which figure is to be applied based on the law of the state.

3 Remington on Bankruptcy, supra;
Dixon v. Koplar, supra;
West v. American Tel. & Tel. Co., supra.

The excess over the exemption, *regardless of what the exemption may be,* passes to the trustee.

Kilgo v. United Distributors, supra;
In re Miller, supra;
Bank of Nez Perce v. Pindel, supra.

There is, therefore, no quarrel with *Lockwood v. Exchange Bank,* 190 U.S. 294, 23 S. Ct. 751, 47 L. Ed.

1061 (Appellee's Brief, p. 7), nor any problem of its application to the instant case.

Appellee cites cases in his brief dealing with the rights of creditors as against whom the bankrupt has waived an exemption. In certain states, in the southeastern part of our country, it is not against public policy for a debtor to waive in advance his right to a certain exemption as against a particular creditor. (In California, such a waiver has been declared to be against public policy. *Industrial Loan and Investment Company of San Francisco v. The Superior Court,* 189 Cal. 546.) As a result it appears from the decisions in Georgia, for example, that no lending institution will loan money without such a waiver. Such a waiver is personal to the individual creditors, and therefore the bankruptcy courts in those states set aside to the bankrupt the homestead and permit the particular creditor to assert his rights in the state court as against the homestead after it is set aside. This is all that such cases as *Woodruff v. Cheeves,* 105 Fed. 601, 5 ABR 296, and *Lockwood v. Exchange Bank,* supra, hold. In the instant case we are not dealing with creditors holding a contractual waiver of homesteads personal to them, but with a group of creditors as against whom the state could not increase the homestead exemption. In the absence of bankruptcy, such creditors in California would have to obtain an execution lien on the homesteaded property to reach the excess over the $7,500.00 exemption (California Civil Code, Section 1245 et seq.). The

trustee in bankruptcy is deemed to have such a lien by virtue of Section 70c of the Bankruptcy Act and is thus vested with title to such excess. This is a far cry from a personal waiver given by the debtor to an individual creditor which could not pass to the trustee. In order to effectuate the policy of those states which in their wisdom, or lack of it, permit advance waivers of exemption, the local federal courts must permit such a creditor to enforce his rights in the state court. The title of the trustee in bankruptcy is not involved.

In *In re Buckley,* 24 F. Supp. 832, cited by Judge Murphy in support of his order as authority for the proposition that the remedy of creditors whose rights under California law extend beyond the $12,500.00 exemption, is in the state court (Tr. p. 67), the court, after discussing the facts and questioning the entire procedure, stated, at page 834:

> "Undoubtedly, if the property was worth and there was a possibility of receiving a bona fide offer which would produce for the common creditors a substantial equity, the property could be sold free of encumbrances and *the bankrupt could claim his homestead out of the proceeds.* No such condition exists here.
>
> The title to the property exempt under the laws of the State does not pass to the trustee, and it is his duty, when claimed, to set it aside as such when it becomes clear that the bankrupt is a person entitled to claim it, as here, *and the fair value of the property does not exceed the amount allowed by the State law.*"

One of the two primary purposes of the Bankruptcy Act is to insure equality of distribution to creditors (*Moore v. Bay,* supra; *Buffum v. Peter Barceloux Company,* 289 U.S. 227, 77 L. Ed. 1140, and *Sampsell v. Imperial Paper and Color Corporation,* 313 U.S. 215, 85 L. Ed. 1293)—the other being to enable a bankrupt to obtain a discharge and start anew. The first is the older in point of history. (See 1 Remington on Bankruptcy, Section 1, pages 3 through 5.) To relegate the forty-one creditors with claims of $18,000.00 to the state court would do violence to equality of distribution. The first creditor to obtain a lien might absorb the whole excess value, leaving the remaining creditors without relief. In such a situation creditors would normally resort to the bankruptcy court—an avenue which would be closed to them if appellee's theory were adopted.

We are likewise not concerned with the rights of creditors having valid liens against a homestead who are relegated to the state court for the enforcement of those liens.

Ingram v. Wilson, 125 Fed. 913, 11 ABR 192 (Appellee's Brief, p. 9), involved an entirely different situation. There an individual creditor sought an order from the referee to compel the trustee to sell the homestead for his individual benefit. The trustee did not claim title and the creditor was properly relegated to the state court for any relief to which he might be entitled.

In re Vonhee, 238 Fed. 422, 38 ABR 799, and *Stein v. Bostian,* 133 Fed. 2d 586, involved cases where,

under state law, labor claimants and tax claimants, respectively, had the right to proceed against homestead property. The court rightly held that such priority claimants must seek their relief in the state court.

In re Carl, 38 Fed. Supp. 414, and *Baumbough v. L. A. Morris Plan Co.,* 30 Fed. 2d 816 (Appellee's Brief, p. 25), are not in point. In both cases there was a valid homestead, and no excess over the amount set aside to be considered.

This Court is solely concerned with the extent of the homestead to be set aside to the bankrupt, which, when the real value of the homestead is established, will determine the amount of the excess vesting in the trustee.

Brandt v. Mayhew, 218 Fed. 422, cited by appellant, also involves an entirely different situation. There the trustee attempted to defeat the homestead in its entirety by asserting that he was in the position of having liens antedating the declaration of homestead. Were the court to have adopted the theory of the trustee, the bankrupt would not have received the homestead to which he was entitled under state law.

Appellee's references to the bankruptcy powers of the federal government flowing from the Constitution are surplusage. Every lawyer knows, or should know, that "the impairment of the obligation of contracts" does not apply to the federal government. The question here is what is the law of California, and the constitutional prohibitions against impairment are part and parcel of the exemption laws of this state.

CONCLUSION

In conclusion it is respectfully submitted that under the laws of California the bankrupt is only entitled to a $7,500.00 homestead, all value in excess thereof having passed to the trustee in bankruptcy.

Accordingly the decision and the order of the District Court should be reversed, and the District Court should be directed to enter an order approving the trustee's report on exempt property.

Dated, San Francisco, California,
June 11, 1956.

Respectfully submitted,
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